

**COMMONWEALTH OF MASSACHUSETTS  
BEFORE THE  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

Investigation by the Department of  
Telecommunications and Energy on  
Its Own Motion into the Provision  
of Default Service

D.T.E. 02-40

**COMMENTS OF DUKE ENERGY TRADING AND MARKETING, LLC**

Duke Energy Trading and Marketing, LLC (“DETM”) hereby files the following comments regarding Massachusetts’ provision of Default Service, as requested in the Department of Telecommunication and Energy’s (“Department”) *Order Opening Investigation into the Provision of Default Service* (“*Opening Order*”), D.T.E. 02-40. DETM fully supports the Department’s view that Default Service can be an effective tool for stimulating electric competition in Massachusetts. At the same time, however, DETM believes that the reliability of Default Service, as the provider of last resort (“POLR”) service, must be safeguarded to ensure its availability when other options are not available. It is the balance between protecting Default Service and promoting competition that the Department must strike in this proceeding, and it is for that purpose that DETM submits the following comments.

**I. PROCUREMENT OF DEFAULT SERVICE**

DETM believes that the backbone of any successful POLR service model is the reliability and stability of that service. As noted by the Department in its initial

investigation into Default Service, Default Service must be available to Massachusetts citizens “regardless of any circumstances that may cause them not to receive service from a competitive supplier at a given time.” *Investigation into the Pricing and Procurement of Default Service*, DTE 99-60-A (“1999 Order A”). For that reason, DETM believes that Default Service should be provided by experienced companies with proven track records and the financial stability to manage the risks associated with the electricity market. In particular, DETM supports the continued use of the distribution companies (“DCs”) to provide Default Service for Massachusetts, as these companies have proven their ability to provide Default Service under any circumstance. The DCs have the experience and financial resources to navigate the sometimes tumultuous energy market and, in the event of a supplier’s default, the DCs have the tools to negotiate, often in real time, imbalance service agreements or a variety of new supply arrangements to meet their obligations. It is this proven experience that must be the baseline for Massachusetts’ POLR service.

Moreover, the risks of opening Default Service to other entities simply outweigh any foreseeable benefits at this time. Although a new retail company may offer what appears to be the same service at a lower price, that company is unlikely to have the experience or financial resources to develop an appropriate risk management capability required to manage short-term, and sometimes drastic, price or supply fluctuations caused by such events as supplier default, inclement weather, or high natural gas prices. Indeed, in the event that a Default Service supplier defaults, a retail provider without established credit or financial assurances will face difficulty in procuring additional resources and will likely pay a higher price to obtain that additional energy. In short, DETM believes that Default

Service, as the backstop for electricity service in Massachusetts, must be in secure hands and it appears that the current DCs are best situated for that purpose.

DETM also supports the continued use of six-month to one-year contracts for procuring Default Service. As was true when the Department initially approved the use of these contracts in its *Investigation into the Pricing and Procurement of Default Service*, DTE 99-60-B (“1999 Order B”), shorter term contracts provide less exposure to migration risks and provide suppliers with better ability to cover price fluctuations. 1999 Order B at 16-19. This stability, with respect to price and supply risk, ensures that suppliers are better situated to gauge the costs of supplying such service and provides greater security against default. Notwithstanding this extra security, DETM believes that these contracts benefit Default Service customers by giving them prices based on wholesale competition, as suppliers compete for these contracts. Ultimately, these short-term contracts provide a nice balance between beneficial wholesale competition and safeguarding Default Service and, thus, should be retained in Massachusetts’ provision of Default Service.

## **II. PRICING DEFAULT SERVICE**

DETM also believes that in order to develop competitive opportunities for residential and other small load customers there must be a price differential between Default Service and competitive supply to reflect the difficulty associated with projecting the load requirements for Default Service customers as a POLR service. Unlike other offerings, where retail customers have contractual and statutory limitations on leaving the service, Default Service customers have the option of leaving Default Service at any time to

take retail service or to return to Default Service when a retail supplier fails or the customer otherwise chooses to return to such service. This optionality, however, makes forecasting load requirements inherently uncertain and requires suppliers to build in contingent supply arrangements and/or purchase more expensive electricity on the spot market. The failure to account for this optionality, in turn, impacts the growth of competitive markets because, without factoring optionality into Default Service prices, competitive suppliers may not be able to offer prices below the Default Service price and Default Service customers will not have sufficient incentive to leave their service. Indeed, the Department already has recognized a similar problem in the *Opening Order*, when it noted that “below-market” prices for SOS has stymied competitive growth.

As the Department moves forward, especially with the upcoming termination of SOS in 2005, DETM believes that the Department must continue to monitor the market to ensure that Default Service is properly priced to reflect the optionality of that service and to promote competition. Although recent Massachusetts Division of Energy Resources statistics show that Default Service has been priced consistently higher than SOS, which could be interpreted to suggest that the Default Service suppliers are accounting for the optionality associated with that service, the Department should be prepared to re-visit this issue when more customers move from SOS to Default Service. If the Default Service price fails to account for the optionality of the service, which appears to have happened with SOS, then the Department should be prepared to remedy this problem by considering the inclusion of a demand charge. Otherwise, when Default Service replaces SOS in 2005, the development of a competitive may be impeded.

### III. FINANCIAL ASSURANCE PROVISIONS

If the Department determines that entities other than the DCs should be allowed to provide Default Service, DETM urges the Department to adopt financial assurance provisions for these providers. As stated *supra*, DETM believes that the volatility of the electricity market requires Default Service providers to be well-experienced and financially secure and creditworthy. Although the Department may decide to forego the experience requirements, it cannot ignore the financial security and creditworthiness criteria. Like many transmission system operating organizations and other states, the Department must enact certain financial assurance provisions to protect Massachusetts citizens and other electricity providers and suppliers from default.

For example, NEPOOL requires its Participants, which would include most of the current suppliers and providers of electrical service in Massachusetts, to comply with its Financial Assurance Policy, as set forth in Attachment L of its Open Access Transmission Tariff (“OATT”). This policy generally mandates that NEPOOL Participants either: (1) submit to continuous financial monitoring by filing various reports and audits, and maintain an investment grade company rating by Standard and Poor’s (BBB), Moody’s (Baa2), Duff & Phelps, and/or Fitch; or (2) provide financial assurances by posting a letter of credit, a performance bond, or other security. PJM has enacted nearly identical creditworthiness policies in its “Credit Policy” for PJM members. Finally, the Maine Public Utility Commission (“Maine PUC”) has promulgated various financial viability rules for entities providing Standard Offer Service and competitive service. Under these provisions, the Maine PUC has established general licensing requirements and requires

electricity providers to post bonds, letter of credits, or a corporate guarantee (corporate guarantee must be from a parent company with a credit rating of “BBB+” from Standard & Poor’s and Fitch or “Baa1” from Moody’s). *See* MPUC Rules, ch. 301 § 3A(2) (financial assurances for Standard Offer Service Providers); MPUC Rules, ch. 305 § 2B(1) (financial assurances for competitive suppliers). These financial guarantees are provided to ensure “funding for replacement generation service in the event that the standard offer provider fails to provide for uninterrupted service to consumers.” MPUC Rules, ch. 301 § 3A(2). Finally, the New Jersey Board of Public Utilities has enacted several basic financial assurance provisions, including the requirement that any new application for a competitive supplier include at least a \$250,000 surety bond to pay any taxes, assessments, or contractual obligations to supply electricity. *Energy Deregulation Interim Standards, Licensing and Registration*, EX99030182 at 9.

Unlike these latter provisions, Massachusetts does not have any financial assurance provisions to protect market participants and customers against default. Massachusetts’ application for competitive suppliers merely requires information regarding any bankruptcy proceedings involving the applicant and some evidence of the applicant’s capitalization. These mere statements, however, are not sufficient in the current electricity market. Rather, like the rules in Maine, New Jersey, PJM and NEPOOL, the Department should require basic financial assurance for any entity, other than the DCs, that are allowed to provide Default Service. These provisions will help ensure that these new entities will be able to meet their obligations and will protect against default. The need for such basic

assurances cannot be understated with regard to Massachusetts' Default Service or service of last resort.

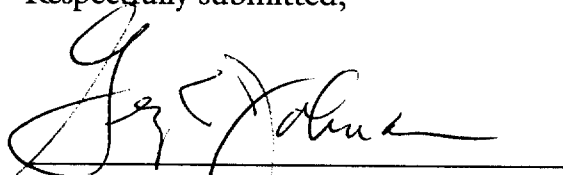
#### IV. CONCLUSION

For the reasons stated above, DETM believes that any Default Service proposal should:

- allow experienced DCs to continue providing such service to ensure that it will be available under any circumstance;
- continue offering Default Service in wholesale contracts ranging from six-months to one-year to attract the maximum number of suppliers to bid on these contracts;
- ensure that Default Service pricing reflects the optionality associated with that service and to promote migration to competitive options; and
- require financial assurance from any non-DCs that are permitted to provide Default Service.

DETM respectfully requests the Department to consider these comments in the above-captioned docket.

Respectfully submitted,



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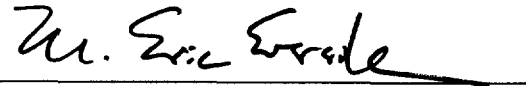
Attorneys for Duke Energy Trading  
and Marketing, LLC

August 8, 2002

## CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing document and eight copies to Secretary Mary L. Cottrell, Department of Telecommunications and Energy, by overnight delivery service. I also served this filing via electronic mail to dte.efiling@state.ma.us, jeanne.voveris@state.ma.us, and the parties listed on the electronic mail service list.

Dated at Washington, D.C. this 8th day of August, 2002.

A handwritten signature in black ink, appearing to read "M. Eric Eversole", is written over a horizontal line.

M. Eric Eversole